STATE OF NEW YORK

DIVISION OF TAX APPEALS

In the Matter of the Petition of ESTATE OF MICHAEL ZAFFARANO, AS PURCHASER OF P & G FUNDING, INC. D/B/A MARDI GRAS for Revision of a Determination or for Refund of Sales and Use Taxes under Articles 28 and 29 of the Tax Law for the Period December 1, 1978 through May 31, 1982. In the Matter of the Petition of MATTHEW IANNIELLO, OFFICER OF P & G FUNDING, INC. D/B/A MARDI GRAS for Revision of a Determination or for Refund of Sales and Use Taxes under Articles 28 and 29 of the Tax Law for the Period December 1, 1978 through February 4, 1986. In the Matter of the Petition of BENJAMIN COHEN, OFFICER OF P & G FUNDING, INC. D/B/A MARDI GRAS for Revision of a Determination or for Refund of Sales and Use Taxes under Articles 28 and 29 of the Tax Law for the Period December 1, 1978 through February 4, 1986.	DETERMINATION DTA NO. 805058

Petitioner Estate of Michael Zaffarano, as purchaser of P & G Funding, Inc. d/b/a Mardi Gras, c/o Theodore Mate, 1501 Broadway, New York, New York 10036, filed a petition for revision of a determination or for refund ofsales and use taxes under Articles 28 and 29 of the

Tax Law for the period December 1, 1978 through May 31, 1982 (File No. 805058).

Petitioners Matthew Ianniello, as officer of P & G Funding, Inc. d/b/a Mardi Gras, 10 Treadwell Drive, Old Westbury, New York 11568, and Benjamin Cohen, as officer of P & G Funding, Inc. d/b/a Mardi Gras, 30 Frost Pond, Roslyn, New York 11576, filed separate petitions for revision of determinations or for refund of sales and use taxes under Articles 28 and 29 of the Tax Law for the period December 1, 1978 through February 4, 1986 (File Nos. 805106 and 806698).

On January 16, 1990, the Division of Taxation by William F. Collins, Esq. (Michael B. Infantino, Esq., of counsel) and petitioners Ianniello and Cohen by Richard H. Champion, Esq., agreed to waive a hearing and have the matter determined on submission of documents. On January 17, 1990, the Division of Taxation by William F. Collins, Esq. (Michael B. Infantino, Esq., of counsel) and petitioner, Estate of Michael Zaffarano, by Theodore Mate, C.P.A. agreed to waive a hearing and have the matter determined on submission of documents. All briefs were due by December 6, 1990. After due consideration of the record, Marilyn Mann Faulkner, Administrative Law Judge, renders the following determination.

ISSUES

I. Whether petitioners Cohen and Ianniello were "persons required to collect tax" under Tax Law § 1131(1) when they were not officers, directors or employees of record of P & G Funding, Inc.

II. Whether the Division of Taxation can use the evidence underlying federal court convictions of petitioners Cohen and Ianniello for RICO violations concerning tax evasion for the period 1978 through November 30, 1982 for the audit period subsequent to November 30, 1982 for purposes of determining a State sales tax assessment and fraud penalty.

III. Whether the Division of Taxation is precluded from proceeding against petitioners Cohen and Ianniello because it allegedly did not timely secure the sales tax owing against the escrow account held by the bulk sale purchaser, the Estate of Michael Zaffarano.

IV. Whether petitioners Cohen and Ianniello should be held liable for sales tax on

$2,000,000.00 in sales when that amount was forfeited to the federal government pursuant to 18 USC 1963(a)(3).

V. Whether the bulk sale purchaser was liable for the sales tax assessment pursuant to Tax Law § 1141(c) when he withheld the consideration owed to the seller in an escrow account and transferred the amount held in escrow to the trustee of P & G Funding, Inc. pursuant to a U.S. District Court order.

FINDINGS OF FACT

As part of their submission, the parties stipulated to certain facts, of which paragraphs one through seven have been incorporated into the following findings of fact.

On or about September 26, 1978, Paul Gelb, as president of P & G Funding Corp., signed with Michael Zaffarano as landlord, a 15-year 3-month lease for property located at 1599 Broadway, New York, New York, to operate a bar called the "Mardi Gras". The lease was effective subject to the State Liquor Authority's ("SLA's") approval and licensing. The period of occupancy was contracted by Paul and Pauline Gelb to run from October 1, 1978 through December 31, 1993.

P & G Funding Corporation ("P & G Funding") d/b/a Mardi Gras Bar, was licensed by the SLA to operate as a bar on or about December 20, 1978. The applicant for the SLA license was Paul Gelb and the application indicated that Paul and Pauline Gelb were the only

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In paragraphs 8 and 9, the parties stipulated that Jerome Brickman and John DiPilato, if called as witnesses, would testify to certain facts as stated in paragraph 8, subparagraph a through d, and paragraph 9, subparagraphs a through h. These purported facts have not been included in the findings of fact. The statements contained in paragraphs 8 and 9 do not substitute for testimony or affidavits by Jerome Brickman and John DiPilato to the same inasmuch as the statements are not sworn or even signed by them. As presented, the stipulation represents mere speculation as to the content of Jerome Brickman's and John DiPilato's testimony if called as witnesses. However, an affidavit by Jerome Brickman was submitted as petitioners' exhibit ten. In that affidavit, Mr. Brickman stated that he was the accountant for P & G Funding and prepared all tax returns for 1978 through 1986 and that during that time neither Benjamin Cohen nor Matthew Ianniello was a shareholder, officer, director or employee of P & G Funding.

stockholders, officers and directors of the business -- Paul Gelb, as president, and Pauline Gelb, as secretary and treasurer.

Reports furnished to the SLA evidenced the fact that Paul and Pauline Gelb used their own funds, to wit, proceeds from the sale of the Plymouth Hotel in Fort Fairfield, Maine, to fund the initial start-up and operation of the bar.

The Mardi Gras commenced operation in January 1979. Pauline Gelb served as the day manager and Paul Gelb operated the bar from approximately 4:00 P.M. until closing.

On or about November 24, 1980, P & G Funding applied to the SLA for a corporate change allowing Paul Gelb to resign as corporate president and transfer his shares of P & G stock to his wife, Pauline Gelb. The SLA

granted the application and Pauline Gelb thereafter served as president and sole stockholder of P & G Funding. The SLA file indicated that an amicable separation in contemplation of divorce of the Gelbs was the basis for the change in title.

All applications for SLA renewal of liquor licenses were thereafter submitted by Pauline Gelb. All applications until 1986 were granted inasmuch as there were no major violations, offenses, or threatened revocations of licenses from the date of the opening of the bar. There were, however, some minor SLA non-compliance summonses issued to the bar.

Sometime shortly after the Mardi Gras obtained its liquor license, Benjamin Cohen and Matthew Ianniello acquired an interest in the profits of the Mardi Gras (Stip., para. 6).

On August 26, 1982, a United States district court judge for the Southern District of New York, approved an application by the Federal Bureau of Investigation (FBI) for electronic surveillance of Benjamin Cohen's business office (C & I Trading, located at 135 West 50th Street, New York, N.Y.). The surveillance, which was installed on September 7, 1982, included both audio and video recording devices placed in various locations within the suite of offices occupied by C & I Trading, including the office of Benjamin Cohen. The electronic surveillance continued until December 27, 1982.

In February 1985, petitioners Cohen and Ianniello, along with others, including Paul and Pauline Gelb, were indicted for, inter alia, unlawfully, willfully and knowingly devising a scheme to evade and defeat a large part of the sales tax on gross sales of P & G Funding due and owing to the Department of Taxation and Finance.

After a jury trial in the Southern District of New York, Benjamin Cohen, Matthew Ianniello and Paul Gelbwere found guilty of, inter alia, a broad conspiracy to violate the Racketeer Influenced and Corrupt Organizations Act, Pub. L. No. 91-452, tit. IX, 84 Stat. 941 (codified as amended at 18 USC §§ 1961-1968 [1982 & Supp. III 1985]), ("RICO"), mail fraud with regard to applications for renewal of liquor licenses before the SLA and the filing of sales tax returns with the New York State Department of Taxation and Finance, and tax evasion. On December 4, 1986, these convictions were upheld by the United States Court of Appeals, Second Circuit, in United States v. Ianniello (808 F2d 184, cert denied 483 US 1006, 107 S Ct 3230, 97 L Ed 2d 736), wherein the Court stated:

> "At trial, the government established that the defendants were part of a group that skimmed profits from bars and restaurants that they owned and operated in New York City. Matthew Ianniello and Benjamin Cohen directed the enterprise's activities, supervising and overseeing its affairs from offices in Manhattan. While they received the greatest profits from its operations, the bars and restaurants ostensibly were owned and managed by others, who acted as 'fronts' for Ianniello and Cohen.
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> As part of the scheme to skim money, the defendants obtained liquor licenses from the SLA for the businesses. Ianniello's and Cohen's financial interests in the receipt of money from the bars and restaurants were concealed from the SLA. This eased the granting of the liquor licenses and made the skimming more difficult to detect.
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> In addition, the scheme included a plan to defraud the New York State Department of Taxation and Finance (the 'Department') by understating gross receipts in sales tax returns....
>
> A lawyer and accountant also participated. Carl Moskowitz ('Moskowitz'), the lawyer, prepared false liquor license applications that were submitted to the SLA for the Mardi Gras, the Haymarket, the Grapevine and the Peppermint Lounge....

Pauline Gelb was acquitted at the close of the government's case.

> The most profitable business was P & G Funding Corp., which operated the Mardi Gras. The bar opened in January, 1979, and for the first two years of its operation the owners of record were Paul Gelb and his wife, Pauline Gelb. Subsequently, Pauline Gelb became the sole owner of record. From the time the Mardi Gras opened its doors in 1979, Ianniello, Cohen and Gelb regularly skimmed its cash receipts, dividing the money equally among themselves. By the end of 1982, the defendants had divided over $2 million in unreported income.
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> The original liquor license application prepared by Moskowitz and filed by the Mardi Gras with the SLA in October 1978 stated that no one other than Paul and Pauline Gelb had a financial interest in the Mardi Gras or would share in the receipts of the bar, hiding Ianniello's and Cohen's stake in the Mardi Gras. This was repeated in the later liquor license renewal applications. These defendants also concealed their skimming at the Mardi Gras from the Department by understating the bar's true gross receipts" (id. at 186-187 [footnotes omitted]).

On February 4, 1986, the Estate of Michael Zaffarano purchased the cancellation of the lease of P & G Funding Corp. for $750,000.00. Thereafter on February 25, 1986, the Estate of Michael Zaffarano notified the Department of Taxation and Finance of the bulk sale stating that it was not purchasing any equipment or furnishings or other personalty left on the premises but that the $750,000.00 was consideration to surrender the lease and vacate the premises.

On March 18, 1986, the Department assigned a sales tax auditor, Osteen Richardson, to conduct an audit of P & G Funding. On March 21, 1986, the auditor attempted to visit the premises but the business was closed. He then spoke to Pauline Gelb by telephone and was referred to her attorney, Mr. Pollok, who on March 26, 1986 informed the auditor that any available business records were in the possession of the U.S. Attorneys, Robert Allman and Randy Mastro. Randy Mastro directed the auditor to U.S. Attorney John Sabetta who was the custodian of P & G's records. The auditor discussed the case with Mr. Sabetta on the telephone on March 27, 1986 and followed up the discussion with an appointment letter requesting that he make available on April 15, 1986 all books and records of P & G Funding for the audit period March 1, 1983 through February 28, 1986. Among the documents requested were journals, ledgers, sales invoices, purchase invoices, cash register tapes, exemption certificates, and sales tax records, daily sales readings and Federal income tax returns.

At the appointment the auditor reviewed the sales tax returns with worksheets and bank statements for the business's three bank accounts. Subsequently, the auditor was also provided

with a general ledger, a cash receipts journal, a check disbursements journal, and Federal corporate income tax returns for 1982, 1983, and 1984.

The auditor's worksheets indicated that the following amounts were reported as taxable sales for each quarter:

2/79	$ 22,701.00		11/82		$192,644.00
5/79	111,455.00		2/83	172,352.00	
8/79	180,899.00		5/83	171,394.00	
11/79	201,063.00		8/83	174,487.00	
2/80	211,641.00		11/83		205,109.00
5/80	171,046.00		2/84	235,472.00	
8/80	183,182.00		5/84	260,433.00	
11/80	159,542.00		8/84	256,657.00	
2/81	159,345.00		11/84		254,281.00
5/81	177,515.00		2/85	233,065.00	
8/81	174,377.00		5/85	250,063.00	
11/81	176,721.00		8/85	210,165.00	
2/82	167,109.00		11/85		254,657.00
5/82	190,981.00		2/1/85 to 2/4/86		143,175.00
8/82	194,476.00				

At no time was the auditor presented with source documents (e.g., sales invoices, purchase invoices, receipts, cash register tapes).

The auditor also discussed the case with numerous U.S. attorneys and agents concerning the federal conviction against petitioners Cohen and Ianniello and read the court documents including the Special Verdict Form concerning the case. Based on this information and the court's finding that petitioners Cohen and Ianniello had defrauded various federal and state governmental agencies, including the New York Department of Taxation and Finance, by preparing false documents, the auditor moved the audit period back to December 1, 1978 to correspond with the federal investigation and court findings. The auditor also determined that the business books and records provided were inadequate for performing a detailed and accurate audit.

Inasmuch as the Special Verdict Form stated that petitioners Cohen and Ianniello had "skimmed", as unreported sales, over $2,000.000.00 from the sales of Mardi Gras over a four-year period, the auditor determined that there were at least $500,000.00 in unreported sales a

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The $2,000,000.00 was based on a conversation on November 22, 1982 between Benjamin

year over the entire audit period. Using this amount, he determined that there were additional unreported sales of $125,000.00 per quarter and multiplied the quarterly sales by 28.733 quarters (December 1, 1978 - February 4, 1986 [the date of the sale of the business]). The auditor arrived at additional sales of $3,592,000.00 for the entire audit period with $292,902.50 in additional sales tax due. The auditor also determined that petitioners Cohen and Ianniello were responsible similar to officers for any sales tax due based on the information contained in the U.S. court documents and Special Verdict Form that they had ownership in, as well as control over, the business.

On February 4, 1986, the Estate of Michael Zaffarano purchased the balance of P & G Funding's lease for $750,000.00. The Estate notified the

Department of the bulk sale by notification of sale, dated February 25, 1986.

Three notices of determination and demands for payment of sales and use taxes due, dated May 23, 1986, were issued separately to Benjamin Cohen and Matthew Ianniello, as persons responsible for the collection of sales tax, and the Estate of Zaffarano, as the bulk sale purchaser. The notices assessed a tax deficiency in the total amount of $292,902.50, a fraud and omnibus penalty in the amount of $149,272.75 and interest in the amount of $166,290.20 for the audit period December 1, 1978 through February 4, 1986.

The Department of Taxation and Finance had previously sent two Notices of Claim to Purchaser, dated February 27, 1986 and April 23, 1986, to the Estate of Zaffarano stating that no distribution of funds, to the extent of the amount of the State's claim for any sales and use taxes, may be made before (1) the State Tax Commission had determined the seller's liability, if any, (2) payment of such liability had been made to the State (payment might be made from the funds being withheld in accordance with Section 1141[c] of the Tax Law), and (3) the Department of Taxation had authorized the purchaser to release the funds or property.

Cohen and Paul Gelb that was recorded by the FBI during the course of its investigation.

In accordance with the Department's Notice of Claim to Purchaser, $675,000.00 of the purchase price for the lease cancellation was placed in escrow with the Estate's attorney Linnett, Schechter, Reicher & Altman. According to the unrefuted statement made by the Estate's representative in his submission papers, the remaining $75,000.00 was paid to the New York State Department of Taxation and Finance for gains tax owed by P & G Funding on the sale of its leasehold rights.

On March 24, 1986, John C. Sabetta was appointed trustee of the assets of P & G Funding in accordance with a court order dated March 13, 1986, by the U.S. District Court, Southern District. The court order provided, in pertinent part:

> "The Court shall appoint a trustee, to be selected by plaintiff [United States] and approved by the Court for the purpose of identifying and marshalling the assets of P & G Funding Corp; [and] arranging for the payment of all cash assets of P & G Funding Corp. into the United States District Court for the Southern District of New York."

By letter dated March 28, 1986, Mr. Sabetta, requested that all assets of P & G Funding held by Linnett, Schechter, Reicher & Altman, to wit, the $675,000 held in escrow on behalf of the Estate of Zaffarano, be transferred to him as trustee. In response to this letter, Norman H. Schaumberger, on behalf of the law firm, wrote to Mr. Sabetta enclosing the Notice of Claim to Purchaser received by the Estate and stating:

> "Under the circumstances, I am directed to hold the funds pending receipt from the State of a determination or authority to release the funds.
>
> Should this create an issue, it is suggested the matter be taken up with the appropriate Department."

By Notice of Motion dated February 12, 1987, Mr. Sabetta moved in the U.S. District Court, Southern District, for an order directing the law firm of Linnett, Schechter, Reicher &

A check for $575,000.00, which had been issued to Pauline Gelb, was endorsed to Linnett, Schechter, Reicher & Altman to be held in escrow along with $100,000.00. The $575,000.00 was placed in an interest bearing account and the $100,000.00 was placed in a non-interest bearing account.

Altman to transfer to him the cash

assets of P & G Funding held in escrow by the law firm on behalf of the Estate. The Notice of Motion was sent to both Dennis Spillane, of the Tax Enforcement Division, and Michael Alexander, as Director of Litigation of the New York State Department of Taxation and Finance. In his affidavit in support of the motion, Mr. Sabetta stated that Linnett, Schechter, Reicher & Altman refused to transfer the escrow funds to him as trustee of P & G Funding because it was concerned that to do so without court authorization would expose it to tax liability. Mr. Sabetta also stated in the affidavit that the order sought was not "intended to affect in any way the rights of the parties and other interested persons in and to the $675,000 of P & G Funding's assets now held by Linnett, Schechter."

On May 12, 1987, Judge Charles S. Haight, Jr., of the U.S. District Court, Southern District, granted the motion to transfer the $675,000.00 to Mr. Sabetta, as trustee. In its memorandum opinion and order, the court noted that only New York State resisted the motion because it was concerned that the State would lose its first priority lien if the order were issued. However, the court decided that the validity of New York State's claim to priority status over the funds at issue had not been litigated, might have to be in the future but was not being determined at that time. The court concluded that:

> "An order directing the transfer of the $675,000.00 to the trustee that bars the trustee from distributing those funds except upon motion with notice to all claimants causes no prejudice to New York and accomplishes the purposes of this Court's March 13, 1986 Order."

Thereafter, by check dated June 26, 1987, the law firm of Linnett, Schechter, Reicher & Altman paid over to the Clerk of the U.S. District Court $720,941.17, the amount held in escrow plus interest on behalf of P & G Funding. This amount was deposited at Mr. Sabetta's

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The March 13 Order directed that a trustee be appointed for the assets of P & G Funding (see Finding of Fact "21").

request in an interest bearing account subject to further orders of the court disposing of the funds of P & G Funding.

Petitioners challenged their respective notices of determination. With regard to petitioners Ianniello and the Estate of Zaffarano, a conciliation conference was held on June 18, 1987 and the statutory notices were sustained by two conciliation orders dated October 30, 1987. With regard to petitioner Cohen, a conciliation conference was held on June 14, 1988 and the statutory notices were sustained by conciliation order dated December 16, 1988.

Petitioners Cohen, Ianniello and the Estate of Zaffarano brought petitions dated, respectively, March 13, 1989, January 26, 1988 and January 13, 1988, challenging their respective notices of determination.

SUMMARY OF THE PARTIES' POSITIONS

Petitioners Cohen and Ianniello argue that because they were neither officers, directors nor employees of P & G Funding, they were not persons required to collect tax pursuant to Tax Law § 1131(1); that neither the conviction of petitioners nor the contents of a recorded conversation in November 1982 can serve as an appropriate basis for assessing the sales tax deficiency or fraud penalty subsequent to the quarter ending November 30, 1982; that the Division should be precluded from proceeding against petitioners because it allegedly did not timely secure the amount owed by petitioners against the escrow account held on behalf of P & G Funding by the Estate of Zaffarano; and that no sales tax can be sustained when the sales ($2,000,000.00) were forfeited, as was done here pursuant to 18 USC 1963(a)(3), in their entirety, to the Federal government.

Petitioner, the Estate of Zaffarano, contends that contrary to the Division's assertion in its brief, $575,000.00 was not paid to Pauline Gelb, but that the entire $675,000.00 was held in escrow by the law firm on behalf of the Estate as required by the Department of Taxation until it was transferred to the court-appointed trustee of P & G Funding pursuant to the U.S. District Court Order. Therefore, petitioner contends that the assessment against it be abated. Petitioner further asserts that the tax deficiency is overstated because the auditor did not select

an audit method reasonably calculated to reflect the tax due or a method that would consider factors in the period after 1982 such as increased competition or a general drop in business.

The Division argues that the vendor lacked verifiable records of its sales and that absent such verifiable records the auditor was entitled to select a method of audit reasonably calculated to reflect the tax due. The Division's counsel contends that the auditor reasonably relied on the evidence that led to the convictions of petitioners Cohen and Ianniello for RICO violations etc. in estimating the amount of unreported income and, hence, the sales tax due. Similarly, asserts the Division, the evidence that provided the basis for petitioners Cohen's and Ianniello's convictions with regard to the 1978 through 1982 period is sufficient to demonstrate fraudulent intent to submit false sales tax returns for the entire audit period from 1978 through 1986.

The Division further argues that petitioners Cohen and Ianniello are personally liable for the tax assessed under sections 1131 and 1133 of the Tax Law inasmuch as they had full knowledge of the corporation's undertakings and exercised control over its affairs. In the alternative, argues the Division, petitioners were de facto officers required to collect tax because they exercised official duties without being lawful officers.

The Division rejects petitioners Cohen's and Ianniello's contention that the forfeiture of the "skimmed" funds precludes the Division from holding them liable for the sales tax due on those amounts.

With regard to the Estate of Zaffarano, the Division's counsel alleges that by the purchaser's own admission it paid $575,000.00 to Pauline Gelb, $100,000 to the escrow agent and $75,000.00 to pay other taxes apparently owed "and that such an arrangement "does not constitute escrowing of the entire purchase price." The Division further states that the subsequent court-mandated transfer "to the Rico civil trustee neither provides a defense to the purchaser, under section 1141(c), nor does it deprive this Department of its priority lien" (Division's brief at 16).

CONCLUSIONS OF LAW

A. Petitioners Cohen and Ianniello contend that they are not personally liable for the sales taxes assessed because they were not persons required to collect tax under Tax Law § 1131(1) inasmuch as they were not shareholders, officers, directors or employees of P & G Funding and their convictions for federal crimes do not create such personal liability under Tax Law §§ 1131 and 1133.

Tax Law § 1133(a) provides that:

> "every person required to collect any tax imposed by [Article 28] shall be personally liable for the tax imposed, collected or required to be collected under this article."

Tax Law § 1131(1) provides that persons required to collect tax:

> "shall include: every vendor of tangible personal property or services; every recipient of amusement charges...and shall also include any officer, director or employee of a corporation...who as such officer, director or employee is under a duty to act for such corporation...in complying with any requirement of [Article 28]."

In determining whether an individual is personally liable under these statutes, consideration must be given to the particular facts in each instance (20 NYCRR 526.11[b][2]; Matter of Cohen v. State Tax Commn., 128 AD2d 1022, 513 NYS2d 564, 565; Vogel v. New York State Dept. of Taxation and Finance, 98 Misc 2d 222, 413 NYS2d 862, 865; Matter of Constantino, Tax Appeals Tribunal, September 7, 1990).

It has been held that the fact that an individual was an officer of a corporation does not in itself make that individual personally liable (Matter of Blodnick v. New York State Tax Commn., 124 AD2d 437, 507 NYS2d 536, 537, appeal dismissed 69 NY2d 822, 513 NYS2d 1027) because the pivotal question is whether the individual had or could have had sufficient authority and control over the affairs of the corporation to be considered a responsible officer or employee. Thus, a variety of factors are considered such as: the individual's status as an officer; the individual's knowledge of and control over the financial affairs of the corporation; the authority to write checks on behalf of the corporation; the authority to hire and fire employees; the preparation, filing and signing of tax returns for the corporation; and the individual's economic interest in the corporation (Matter of Cohen v. State Tax Commn., supra,

513 NYS2d at 565; Matter of Blodnick v. New York State Tax Commn., supra, 413 NYS2d at 865; Matter of Constantino, supra). While there is case law which relieves a named officer from personal liability for sales tax due from a corporation because he or she does not have the requisite authority or control over the financial affairs of the corporation, the question here is whether a "person required to collect tax" under Tax Law § 1131(1) also includes one who is not an officer, director or employee of the corporation even though he or she may have the requisite authority or control over a corporation that would make an officer, director or employee liable.

The Division's counsel relies on United States v. Graham (309 F2d 210 [9th Cir 1962]) in support of his position that the definition of "person" in Tax Law § 1131(1) does not exclude petitioners Cohen and Ianniello. In Graham, a similar issue was before the Court with regard to the federal statute which defined "a person required to collect" tax (26 USC §§ 6671[b]; 6672). Section 6671(b) stated that the term "person...includes an officer or employee of a corporation, or member or employee of a partnership...." The question in Graham was whether a member of a corporation's board of directors could be a "person" required to collect tax when that member was not an employee or officer of the corporation. The Court held that the term "person" under the statute "does include officer and employee but certainly does not exclude all others" (id. at 211-212). The Court stated that the definition of person should not be read narrowly, that it "illustrated rather than qualified the specified examples..., [and that it] must be construed to include all those so connected with a corporation as to be responsible for the performance of the act in respect of which the violation occurred" (id. at 212). However, the Tax Appeals Tribunal confronted the same issue in Matter of Cambria (Tax Appeals Tribunal, September 1, 1988), but acknowledged that it was not following the holding in United States v. Graham. In Cambria, the Tribunal noted that Tax Law § 1131(1) was amended in 1985 to include the word "director" along with an officer and employee of a corporation as a "person required to collect tax". The Tribunal determined that the addition of the word "director" was a material change indicating a legislative construction that the law prior to its amendment did not

impose liability upon directors of corporations. In distinguishing its result from that in United States v. Graham (supra), the Tribunal stated that:

> "[w]hile the analysis of the Graham decision would otherwise be persuasive, its impact here is diminished because in Graham the Court was not confronted with a legislative enactment and the evidence of legislative intent directing our interpretation" (Matter of Cambria, supra at 5).

While the Tribunal did not follow the result in Graham, its decision did not reject the basic premise that consideration must be given to the particular facts in each instance. Tax Law § 1131(1) does not impose liability simply because a person was an officer, director or employee of a corporation and, conversely, should not relieve a person from liability simply because he or she is not an officer, director or employee of the corporation. Tax Law § 1131(1) was not intended to cover every possible situation that may arise to make a party liable as a "person required to collect tax". In Cambria, the Tribunal noted that the taxpayer's only formal involvement with the corporation was that of director. However, in the present situation, petitioners possessed all the indicia of control that would make an officer, director or employee liable. Petitioners cannot escape liability merely because they were not listed as the officers or directors of record of P & G Funding. As noted in United States v. Ianniello (supra, see Finding of Fact "10"), Paul and Pauline Gelb functioned as "fronts" for petitioners Cohen and Ianniello as part of their scheme to skim money. That petitioners had a substantial economic interest in, and substantial control over, the finances of P & G Funding is evidenced by the fact that they received $2,000,000.00 of unreported sales income over a four-year period. Certainly the definition of "persons required to collect tax" in Tax Law § 1131(1) does not act as a shield to protect petitioners from sales tax liability simply because they devised a scheme to conceal their involvement with P & G Funding. As argued by the Division's counsel, petitioners acted as de facto officers or directors. With full knowledge and sufficient control

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In a different but similar context the courts have held that they have the authority to pierce the corporate veil and look beyond the corporate form where necessary to prevent fraud or to achieve equity (Port Chester Elec. Const. Corp. v. Atlas, 40 NY2d 652, 389 NYS2d 327; Walkovszky v. Carlton, 18 NY2d 414, 276 NYS2d 585 [liability extended to shareholder when the corporation is a "dummy" for individual stockholders who are in reality carrying on the

over the finances of P & G Funding, they failed to report taxable sales from which they derived personal benefits. Holding them responsible as "persons required to collect tax" comports with the legislative intent of Tax Law § 1131(1) to combat tax evasion and improve tax enforcement (see, Governor's Bill Jacket L 1985, ch 65).

B. Tax Law § 1135(a) provides that "[e]very person required to collect tax shall keep records of every sale...in such form as the commissioner of taxation and finance may by regulation require." These records must be kept in a manner suitable to determine the correct amount of tax due and must be available for the Division's inspection upon request (Tax Law § 1135[d]; 20 NYCRR 533.2[a][2]). The regulations provide that among the sales records required to be maintained are "sales slip, invoice, receipt, contract, statement or other memorandum of sale, ...cash register tape and any other original sales document" (20 NYCRR 533.2[b][1]).

In order to determine the adequacy of a taxpayer's records, the Division must first request and thoroughly examine the taxpayer's books and

records for the period of the proposed assessment (Matter of Adamides v. Chu, 134 AD2d 776, 521 NY2d 826, 828 lv denied 71 NY2d 806). The purpose of this requirement is to give the taxpayer, who has honestly and conscientiously maintained comprehensive records, an opportunity to present such documents with the expectation that such documents will not be ignored but will be used as the basis for determining tax liability (Matter of Chartair, Inc. v. State Tax Commn., 65 AD2d 44, 411 NYS2d 41, 43; see, Matter of Adamides v. Chu, supra at 828).

When the taxpayer's records are incomplete or unreliable for determining accurate sales, the Division may resort to a test-period audit using external indices (Matter of Hanratty's 1732 Amsterdam Tavern, Inc. v. New York State Tax Comm., 88 AD2d 1028, 451 NYS2d 900, 902,

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business in their personal capacity for purely personal rather than corporate ends]).

lv denied 57 NY2d 608; Matter of Korba v. New York State Tax Comm., 84 AD2d 655, 444 NYS2d 312, 314, lv denied 56 NY2d 502, 450 NYS2d 1023), or select a method of audit reasonably calculated to reflect the tax due (Matter of Urban Liquors, Inc. v. State Tax Commn., 90 AD2d 576, 456 NYS2d 138, 139, citing Matter of Grant Co. v. Joseph, 2 NY2d 196, 206, 159 NYS2d 150, cert denied 355 US 869). In such circumstances, petitioner has the burden of demonstrating by "clear and convincing" evidence that the method of audit or amount of the tax assessed was erroneous" (id.).

Here, it is unrefuted that when the tax auditor spoke with Pauline Gelb concerning the audit of P & G Funding that she referred him to her attorney, Mr. Pollok, who in turn informed him that any available business records were in the possession of the U.S. attorneys in connection with the RICO convictions. The auditor was then referred to John Sabetta, trustee of P & G Funding, who presented the auditor all books and records in his possession. Petitioners Cohen and Ianniello do not contend that the tax auditor failed to obtain all the books and records available nor do they assert that there are other records that would refute the basis for the auditor's determination.

Inasmuch as the books and records made available to the auditor did not contain any original source documents (e.g., sales invoices, purchase invoices, receipts or cash register tapes) and the RICO convictions and supporting documents evidenced tax evasion and fraudulent tax returns for the period 1978 through 1982, the auditor reasonably concluded that the records made available were unreliable and bore no relationship to the amount of sales tax due. Petitioners do not appear to object to the Division's estimate of the amount of unreported sales for the period December 1, 1978 through November 30, 1982.

Petitioners do argue, however, that because the Mardi Gras did not open until January 1979 and was not licensed to sell alcoholic beverages until January 18, 1979, they were being assessed for an audit period when the Mardi Gras was neither open for business nor able to sell alcohol. This argument has little merit inasmuch as the auditor merely prorated the $2,000,000.00 of skimmed funds for the audit period up until November 30, 1982 over which time such skimming occurred.

The Division's reliance on the U.S. court finding that petitioners Cohen and Ianniello skimmed $2,000,000.00 from the sales of the Mardi Gras for 1978 through 1982 was reasonable for purposes of estimating sales tax due for that period. The dispute focuses, however, on whether the Division can use the same proof as evidence of continued underreporting for the audit period after November 30, 1982. Petitioners argue that the contents of the recorded conversation on November 22, 1982 cannot serve as a basis for sales tax assessments subsequent to the quarter ending November 30, 1982. Petitioners allege that it was illogical to assume that the practice of

skimming "continued wholly unabated" once it became apparent to petitioners that the skimming by them was being investigated (Pet. Brf. at 10). Petitioners contend that they became aware of the FBI investigation approximately one year after the conclusion of the electronic surveillance and that it was "not coincidental that...increases [in reported sales] corresponded precisely with the issuance of grand jury subpoenas to various employees and record owners of the bars in which petitioners [were] ultimately convicted of having an interest" (Pet. Brf at 9). Petitioners note that "[a]ny doubt that they may have had as to the nature of the government's investigation was eliminated with the filing of the indictment against them in February, 1985" (id.). Petitioners Cohen and Ianniello also argue that the audit method employed subsequent to November 30, 1982 is neither authorized nor sanctioned by Tax Law § 1138 which permits the use of "external indices", such as stock on hand, purchases, rental paid, the number of employees or other factors. Petitioners characterize the Division's estimate for the sales tax due for the period subsequent to November 1982 as the "wild guess" method.

Although the Division's reliance on the same proof for the periods prior and subsequent to November 30, 1982 is problematic, it was not unreasonable under the circumstances. It has been held that "[n]either exactness in an audit nor an item-by-item analysis is required when petitioner's own faulty record keeping prevents exactness in the determination of the tax liability" (Matter of Day Surgicals, Inc. v. State Tax Commission, 97 AD2d 865, 469 NYS2d

262, 265; see, Matter of Skiadas v. State Tax Comm., 95 AD2d 971, 464 NYS2d 304, 305; Matter of Korba v. New York State Tax Comm., 84 AD2d 655, 444 NYS2d 312, 314, lv denied 56 NY2d 502, 450 NYS2d 1023; Matter of Commissar v. State Tax Comm., 69 AD2d 929, 415 NYS2d 305). Thus, in the absence of reliable records, the Division was entitled to estimate the taxes due. There is no question that the Division could estimate that the Mardi Gras had $500,000.00 of unreported sales per year for the audit period from December 1, 1978 to November 30, 1982 based on the federal conviction and recorded conversation on November 22, 1982 (see, Finding of Fact "16" and footnote "3"). Based on this information it was reasonable for the auditor to assume the same level of unreported sales absent "clear and convincing" evidence by petitioners demonstrating the contrary. The present audit method is similar to the use of a test period or observation test audit to the extent that the results of an audit of a smaller time frame is deemed representative of the entire audit period.

The only evidence presented by petitioners to the contrary was that reported sales increased after November 1983, contemporaneous with the issuance of grand jury subpoenas, and that it would be illogical for petitioners Cohen and Ianniello to continue their practice of skimming after they were indicted in February 1985. Although this argument may have some common sense appeal, it does not rise to the level of "clear and convincing" evidence. The increase in the reported sales after November 1983 is not so aberrant as to indicate anything other than normal fluctuations in the business. For example, Mardi Gras' reported taxable sales for the period ending August 31, 1985 had decreased approximately $20,000.00 from the previous quarter ending February 28, 1985 (the month of the indictments) and was approximately the same as the amount of taxable sales reported in February of 1980 (see Finding of Fact "14"). Thus, absent "clear and convincing" evidence to the contrary, the auditor's estimate of sales tax due was reasonably determined.

C. With regard to the fraud penalty, petitioners Cohen and Ianniello similarly argue that their convictions in the U.S. courts for their actions prior to November 30, 1982 should not serve as a basis for assessing a fraud penalty for the audit period subsequent to the quarter

ending November 30, 1982. Tax Law § 1145(a)(2) provides that if the failure to file a return or to pay over any tax to the Division of Taxation within the time required by Article 28 is due to fraud, then the Division shall impose a penalty of 50 percent of the tax due. In order to support a finding of fraud, the Division must establish by "clear, definite and unmistakable evidence" every element of fraud, including "willful, knowledgeable and intentional wrongful acts or omissions constituting false representations, resulting in deliberate nonpayment or underpayment of taxes due and owing" (Matter of Chateau Chemists, Inc., State Tax Commission, May 4, 1984 [TSB-H-84(67)S]).

While consistent and substantial underreporting of large amounts of taxable income over a period of years is strong evidence of fraud, the mere understatement of income, standing alone, is not sufficient to establish fraud (Merritt v. Commr., 301 F2d 484, 487). Because the burden of proving fraud rests with the Division, an anomalous situation may occur where a taxpayer cannot meet its burden of overcoming a tax deficiency based on underreporting yet the Division also cannot meet its burden of proving that the underreporting was fraudulent (see, Matter of Cousins Service Station, Inc., Tax Appeals Tribunal, August 11, 1988). Thus, the mere fact that a taxpayer is unable to prove that a deficiency assessment is erroneous, is not sufficient in itself to establish the burden of proving fraud.

A taxpayer's conviction for fraudulently filing false tax returns collaterally estops the taxpayer from challenging the civil fraud penalty imposed pursuant to Tax Law § 1145(a)(2) only for the same period covered by the conviction (see, Plunkett v. Commr., 465 F2d 299 [7th Cir 1972]; Matter of J. Botwinick & Sons, Inc., State Tax Commn., December 5, 1986 [TSB-H-87(30)S]; Matter of Chateau Chemists, Inc., supra [guilty plea collaterally estops taxpayer from contesting civil fraud penalty only for that period to which he entered a plea of guilty to the criminal charge]). For the periods outside those which are covered by a guilty conviction, the Division is required to carry its burden of proof. However, fraud need not be established by direct evidence, but can be established by circumstantial evidence by surveying the taxpayer's entire course of conduct in the context of the events in question and drawing reasonable

inferences therefrom (Plunkett v. Commr., supra at 303; Matter of A. Charles Cinelli, Tax Appeals Tribunal, September 14, 1989, citing Karecky v. Commr., 781 F2d 1566 [11th Cir 1986]; Briggs v. Commr., 440 F2d 5 [6th Cir 1962]).

Although the criminal convictions for fraud for the audit period prior to the quarter ending November 30, 1982, cannot alone serve as the basis for civil fraud penalties for the audit period subsequent to November 30, 1982, the total context of events, including the reason for the consistent and substantial underreporting and the ongoing relationship of petitioners Cohen and Ianniello with the Mardi Gras up until and after their indictments in February 1985 provide sufficient evidence to reasonably infer fraudulent intent for the entire audit period (see, Merritt v. Commr., supra; Matter of A. Charles Cinelli, supra).

D. Petitioners Cohen and Ianniello claim that the Division should be precluded from proceeding against them because it allegedly did not timely secure the tax liability owed by petitioners against the escrow account held on behalf of P & G Funding by the bulk sale purchaser, the Estate of Zaffarano. This claim is without merit. The tax liability assessed against the three petitioners was separate and independent. Although the satisfaction of the debt by one may relieve the liability imposed on the others, the failure of one party to satisfy the debt, regardless of the reason, does not relieve the liability imposed on others. All parties are equally liable under the statute and the reason for the Division's failure or inability to obtain satisfaction of the debt against one party is immaterial to the continued liability of any other individual who is liable under the statute.

E. Finally, petitioners Cohen and Ianniello contend that because they forfeited the $2,000,000.00 in sales to the Federal government pursuant to 18 USC 1963(a)(3), they are not liable for sales tax on that amount. This argument has no merit. Petitioners failed to pay State sales tax on $2,000,000.00 in sales in a timely manner. Any subsequent disposal of the $2,000,000.00 is immaterial to the sales tax liability that was incurred when the sales were made.

F. Petitioner, the Estate of Zaffarano, argues that it is not liable as a bulk sale purchaser

for the tax assessed against P & G Funding because it transferred the entire $675,000.00 plus interest held in escrow to the court-appointed trustee of P & G Funding pursuant to the U.S. District Court Order. The Division of Taxation argues that by the purchaser's own admission it paid $575,000.00 to Pauline Gelb and that the court-mandated transfer of the money held in escrow to the court-appointed trustee neither provides a defense to the purchaser nor deprives the Division of its priority lien.

As noted by the U.S. District Court decision (see, Finding of Fact "22"), the court-mandated transfer of the funds held in the escrow account to Mr. Sabetta, as trustee of P & G Funding, did not determine the State's claim to a priority lien. This issue should be pursued by the Division with the trustee of P & G Funding. However, the effect of the court order was to relieve the Estate of Zaffarano from tax liability as a bulk sale purchaser. The intent of Tax Law § 1141(c) is to hold the purchaser personally liable to the State for any taxes due from the seller. Under Tax Law § 1141(c), this liability "shall be limited to an amount not in excess of the purchase price or fair market value of the business assets sold, transferred or assigned to such purchaser..., whichever is higher...." Because the purchaser's liability is limited to the extent of the purchase price or fair market value of the assets purchased, it is apparent that the purchaser's liability derives from its thrust-upon role as trustee of the consideration being paid to the seller to the extent of the tax liability.

Here, petitioner complied with Tax Law § 1141(c) by withholding from the seller the entire

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The Division appears to imply that the purchaser did not hold the $575,000.00 paid to Pauline Gelb in an escrow account; however, although the check was made out to Pauline Gelb, it was endorsed to Linett, Schechter, Reicher & Altman and placed in escrow (see, Finding of Fact "20", footnote 4).

The Division concedes that petitioner's liability is limited to the tax deficiency itself plus minimum interest in accordance with the holding in Matter of Velez v. Division of Taxation of Dept. of Taxation and Finance (152 AD2d 87, 547 NYS2d 444).

consideration (minus the $75,000.00 gains tax paid [see, Finding of Fact "20"]) with regard to the leasehold rights and placing the $675,000.00 in escrow. Petitioner refused to transfer the amount held in escrow at Mr. Sabetta's request and released those funds only when required by the U.S. District Court Order.

It is clear from the Court's decision (see, Finding of Fact "23") that the Division was a party to the proceedings before the U.S. District Court and had an opportunity to make its objections against the transfer of the escrowed funds to the trustee of P & G Funding. Inasmuch as these funds are now being held by Mr. Sabetta, as trustee of P & G Funding, the Division should pursue whatever remedies are available to it against Mr. Sabetta to secure its lien on behalf of the State. The Division's lien rights to these funds are no longer dependent on whether the Division continues to hold the Estate of Zaffarano personally liable. In light of the fact that petitioner complied with Tax Law § 1141(c) by placing the consideration for the leasehold rights in escrow and transferred those funds to the trustee for P & G Funding at the direction of a court order, the Estate of Zaffarano should no longer be held personally liable under section 1141(c) (see, Matter of Stel-Ed Operating Corp. d/b/a Campbell Inn, Tax Appeals Tribunal, April 25, 1991).

G. The petitions of Benjamin Cohen and Matthew Ianniello are denied and the notices of determination and demands for payment of sales and use taxes due, dated May 23, 1986, issued to them are sustained.

H. The petition of the Estate of Michael Zaffarano is granted in accordance with Conclusion of Law "F" and the notices of determination and demands for payment of sales and use taxes due, dated May 23, 1986, issued to the Estate of Michael Zaffarano are cancelled.

DATED: Troy, New York

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ADMINISTRATIVE LAW JUDGE